MOODY'S
INVESTORS SERVICE

Rating Action: Moody's changes WEC's rating outlook to negative following acquisition announcement; places Integrys on review for upgrade after revealing plans to divest its retail business

Global Credit Research - 23 Jun 2014

Approximately $10.6 billion of rated debt affected

New York, June 23, 2014 -- Moody's Investors Service, ("Moody's") changed the rating outlook to negative from stable of Wisconsin Energy Corporation (WEC; A2 Issuer and senior unsecured rating, A3 junior subordinated and Prime-1 Commercial paper rating). This rating action follows today's announcement that WEC has entered a definitive agreement to acquire Integrys Energy Group Inc. (Integrys; Baa1 senior unsecured, Baa2 junior subordinated, Prime-2 Commercial paper rating) for $9.1 billion, which includes the assumption of approximately $3.3 million of existing debt.

Concurrently, Moody's put the long-term ratings of Integrys under review for upgrade after the company's disclosure that it is in the process of disposing its unregulated retail operations. The review for upgrade will be concluded shortly, and will focus on the divestiture of the retail operations.

In addition, Moody's also affirmed the ratings of all of the subsidiaries of both WEC and Integrys (listed below). The rating outlooks for these utility subsidiaries are stable.

The transaction is subject to shareholder votes for both companies, the Federal Energy Regulatory Commission, and the state regulatory authorities in Wisconsin, Illinois, Michigan and Minnesota. The transaction is expected to close in approximately 12 months. If completed WEC intends to fund the $5.8 billion equity purchase using a combination of WEC common stock and cash. To fund the portion of the cash consideration(excluding related costs), WEC intends to use around $1.5 billion in proceeds raised in connection with the issuance of long-term and short-term indebtedness under its Commercial Paper Program.

RATINGS RATIONALE

"Upon the completion of the transaction, WEC will benefit from the larger size and the complementary nature of the operations of the combined group in Wisconsin as well as from a more diversified footprint in operational and geographical reach" said Moody's Vice President Natividad Martel. "The latter factors Integrys' multi-state operations and its significant natural gas distribution operations in Illinois via Peoples Gas Light and Coke Company and North Shore Gas Company". The transaction will further enhance WEC's underlying cash flow stability provided by the regulated utility subsidiaries that we believe operate in credit supportive regulatory environments. The combined group's increased ownership in American Transmission Company LLC (ATC; A1 stable) to 60.2% is another credit positive. Moody's also notes WEC's intention to terminate its current share repurchase program, and that its target dividend payout ratio will range between 65% and 70% which compares well with its peers.

The change in WEC's rating outlook to negative from stable considers that should the transaction close WEC's credit profile will deteriorate as it acquires a company with a weaker credit profile in a leveraged transaction. The negative outlook reflects the increase in WEC's holding company debt compared to the consolidated indebtedness which will hover around 20% for a sustained period of time. It further considers the introduction of integration risk given WEC's limited acquisition experience and lack of track-record in operating under the Illinois regulatory environment. WEC's negative outlook considers the expected deterioration in WEC's consolidated key credit metrics. Specifically, over the next three years, the ratio of cash flow from operations before working capital adjustments (CFO pre-W/C) to debt and Retained Cash Flow (RCF) to debt is expected to fall below 19% and 15%, respectively. These metrics are more commensurate with the upper-range of the Baa-rating category according to the guidelines provided for standard business risk under the updated Regulated Electric and Gas Utility Methodology, published in December 2013. However, over the longer-term horizon, Moody's expects these financial ratios will start improving such that they score well within the lower-range of the A-rating category and that the combined group will begin to report positive free cash flows, another credit positive.

"The review for upgrade of Integrys' ratings largely reflects the company's plans to completely exit its retail energy services business by divesting this segment" said Lesley Ritter, a Moody's Analyst. "The lower business risk that will result from the elimination of the retail business is the impetus for bringing the ratings of Integrys' one notch closer to its utility subsidiaries. Moody's will focus the review for upgrade on the divestiture of Integrys Energy Services."

Still, the amount of holding company debt compared to Integrys' consolidated indebtedness will remain significant (hovering around 30%). The parent level debt-holders' structural subordination drives the notching relationship between Integrys and its largest subsidiary, Wisconsin Public Service Corporation (WSP; A1 senior unsecured). Moody's also expects that should the transaction close, Integrys will be able to implement a less aggressive dividend policy such that its dividend payout ratio going forward will remain below 70% in the wake of the group's substantial capital expenditure program.

Moody's understands that WEC intends to maintain all the existing bank back-up credit facilities in place. These include those at both holding companies as well as the main subsidiaries which will continue to have access to their own separate facilities. These several facilities are scheduled to expire in 2017 and 2019.

A downgrade of WEC's senior unsecured rating to A3 would also result in a downgrade of its Commercial Paper rating to Prime-2 from Prime-1.

Given WEC's negative outlook limited prospects exist for a upgrade of its ratings.

In light of Intergrys' review for upgrade the likelihood of a rating downgrade is low.

The following debt ratings are affirmed:

Wisconsin Energy Corporation

LT Issuer Rating A2

Senior Unsecured A2

Junior Subordinate A3

Senior Unsec. Shelf (P)A2

Junior Subord. Shelf (P)A3

Pref. Stock Shelf (P)A3

Commercial Paper P-1

Outlook Changed to negative

Wisconsin Energy Capital Corporation

Senior Unsecured A2

Senior Unsecured MTN (P)A2

Outlook Changed to negative

WEC Capital Trust II

Pref. Stock Shelf (P)A3

Outlook Changed to negative

The following ratings have been affirmed:

Wisconsin Electric Power Company

LT Issuer Rating A1

Senior Unsecured A1

Senior Unsec. Shelf (P)A1

Pref. Stock A3

Commercial Paper P-1

Outlook Stable

Wisconsin Gas LLC

Senior Unsecured A1

Commercial Paper P-1

Outlook Stable

Elm Road Generating Station Supercritical

Senior Unsecured (Domestic) A1

Outlook Stable

On Review for Upgrade:

Integrys Energy Group, Inc.

Senior Unsecured Baa1

Jr Subordinate Baa2

Senior Unsecured Shelf (P)Baa1

Subordinate Shelf (P)Baa2

Jr. Subordinate Shelf (P)Baa2

The following ratings have been affirmed:

Commercial Paper at Prime-2

Wisconsin Public Service Corporation

Issuer Rating A1

First Mortgage Bonds Aa2

Senior Secured Aa2

Pref. Stock A3

Senior Secured Shelf (P)Aa2

Pref. Shelf (P)A3

Commercial Paper at P-1

Outlook Stable

Peoples Gas Light and Coke Company

Issuer Rating A2

Senior Secured/First Mortgage Bonds Aa3

Senior Secured MTN (P)Aa3

Commercial Paper P-1

Outlook Stable

North Shore Gas Company

Issuer Rating A2

Senior Secured MTN (P)Aa3

Outlook Stable

The principal methodology used in this rating was Regulated Electric and Gas Utilities published in December 2013. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

Headquartered in Milwaukee, Wisconsin Energy Corporation (WEC) is a diversified energy holding company that conducts operations in an energy segment and, to a much lesser extent, a non-energy segment that primarily invests in real estate. The energy segment includes Wisconsin Electric Power Company (WEPCO) and Wisconsin Gas LLC (Wisconsin Gas). WEC estimates that around 90% and 5% of the group's consolidated revenues are subject to the purview of the Wisconsin and Michigan Public Service Commission (PSCW and MPSC), respectively, while the Federal Energy Regulatory Commission (FERC) oversees the balance. In addition, the group has around 6GW installed capacity, including the four units (2,320 MW) designed, built and financed (the cash costs of this multi-year program aggregated around $2.7 billion) by We Power LLC (We Power: not rated) as part of WEC's Power The Future (PTF) strategy that started in 2000. This program includes two 615MW supercritical pulverized coal-fired generation units located at the Oak Creek facility (OC1 and OC2 in operations since early 2010 and 2011, respectively). WEC indirectly holds its approximately 83% undivided ownership interest in the OC units (equal to 1,057MW) via its other publicly rated subsidiary, Elm Road Generating Station Supercritical, LLC (ERGSS).

Headquartered in Chicago, Illinois, Integrys Energy Group, Inc. (Integrys, Baa1 senior unsecured, stable outlook) is a diversified energy holding company operating in both the regulated (approx. 96% of 2013 operating income) and unregulated (approx. 4% of 2013 operating income) space. As mentioned earlier Integrys currently owns six regulated utilities: Wisconsin Public Service Corporation (WPS), The Peoples Gas, Light and Coke Company (PGL), North Shore Gas Company (NSG), Minnesota Energy Resources Corporation (MERC, not rated), Michigan Gas Utilities Corporation (MGU, not rated) and Upper Peninsula Power Corporation (UPPCO, not rated) albeit it announced its sale in January. In September 2013, MERC entered into an agreement to purchase Alliant Energy Corporation's (A3 senior unsecured) Southeastern Minnesota natural gas distribution business for $11 million. The transaction is expected to close in late 2014. Integrys' largest utility subsidiaries are WPS, a vertically integrated electric utility headquartered in Green Bay, Wisconsin, (50% of consolidated regulated rate base) and PGL, a local gas distribution company (LDC) that operates in and around Chicago (30% of consolidated regulated rate base).

Integrys' sizeable non-regulated retail energy business is largely focused on marketing natural gas and electricity to commercial, industrial and residential customers primarily in the northeastern quadrant of the U.S. We estimate Integrys' non-regulated energy marketing business accounts for 10-15% of consolidated operating income.

Integrys and WEC (via WEPCO and ATC Holdings) also hold a 34% and 26.2% ownership-stake, respectively, in the American Transmission Company LLC (ATC, A1 senior unsecured).

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